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RR RUEHWEB

DE RUEHKV #0114/01 0181346
ZNR UUUUU ZZH
R 181346Z JAN 07
FM AMEMBASSY KYIV
TO RUEHC/SECSTATE WASHDC 0921
INFO RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOG/USDOC WASHDC
RUCPCIM/CIMS NTDB WASHDC

UNCLAS KYIV 000114

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STATE FOR EB/IFD/OIA (JNHATCHER) AND EUR/UMB
STATE PLEASE PASS TO USTR FOR KLEIN/MOLNAR
USDOC FOR 4201/DOC/ITA/MAC/BISNIS
USDOC FOR 4231/ITA/OEENIS/NISD/CLUCYCK

E.O. 12958: N/A
TAGS: [EINV](#) [ETRD](#) [KTDB](#) [OPIC](#) [USTR](#) [UP](#)
SUBJECT: UKRAINE: 2007 INVESTMENT CLIMATE STATEMENT

REF: A) KYIV 113
B) 2006 STATE 178303

1. Ref A contained part one of the 2007 Investment Climate Statement (ICS) for Ukraine. Part two of the ICS continues below.

Text Continued:

A.5. Performance Requirements/Incentives

PERFORMANCE REQUIREMENTS

There are no known cases of performance requirements imposed on foreign investors other than those clearly spelled out in privatizations conducted via open tender. Ukraine has eliminated measures that conflicted with the WTO Agreement on Trade-Related Investment Measures (TRIMs) in the automobile industry and other sectors in the context of its accession efforts. Some potentially conflicting practices remain in the agricultural sector, however.

INVESTMENT INCENTIVES

Ukraine modified its foreign investment law of 1996 to provide foreign investors a number of state guarantees, the most important being the unhindered and immediate repatriation of profits and stable regulations for the time of the investment. Foreign investors are exempt from customs duties for any in-kind contribution imported into Ukraine for the company's charter fund. Some restrictions apply and import duties must be paid if the enterprise sells, transfers, or otherwise disposes of the property. The Government has drafted legislation to introduce tax incentives for investment within special economic zones.

VISA/WORK PERMIT REQUIREMENTS

According to Ukrainian Presidential Decree No. 1008 dated June 30, 2005 (with amendment dated August 18, 2005), U.S. citizens traveling to Ukraine on short-term tourist, business, or private travel do not need a visa to enter Ukraine. Visas are still required of other categories of travelers including those who intend to study, reside, or work in Ukraine. Short-term travelers entering Ukraine under the auspices of this decree can stay in Ukraine up to 90 days. Any requests for extension of stay due to extenuating circumstances should be directed to the Ministry of Interior's Department of Citizenship, Immigration and Registration (formerly known as OVIR). Extensions are not automatic, however, and are valid only

for continued presence in the country. It is not possible to depart Ukraine and return on the extension, nor can an adjustment to visa status be made from within Ukraine. U.S. citizens do not have to return to the U.S. to renew their visas -- they may apply for and pick up a visa at any Ukrainian Embassy outside of Ukraine. Most go to neighboring Poland, Germany, or the Czech Republic. All foreigners -- except those with permanent residency status -- are required to have a work permit to work in Ukraine. The laws of Ukraine "On Population Employment" and "On the Legal Status of Foreigners" define the procedures for obtaining a permit at the State Employment Service. There is one exception: the Law "On Production Sharing Agreements" allows foreigners under such agreements to be hired without permits.

The Cabinet of Ministers Instruction No. 892, dated September 12, 2005, extended work permits from one year to the tenure of employment for foreign citizens working in managerial or specialized positions in Ukraine and individuals providing services without their commercial presence in Ukraine. Employers must notify employment centers, police, and the State Committee for Border Protection three days before revoking contracts with foreign nationals.

Foreigners residing in Ukraine must register with the government. Effective July 1, 2002, foreigners entering Ukraine are registered automatically by the State Committee on Safeguarding Ukraine's Border at border checkpoints. Foreigners legally coming to Ukraine for short periods no longer need to register at Internal Affairs Ministry Offices.

A.6. Right to Private Ownership and Establishment

The Constitution of Ukraine guarantees the right to private ownership, including the right to own land. A new Land Code consistent with the Constitution was adopted on October 25, 2001. The Land Code provides for foreign ownership of non-agricultural land and clarifies the rights of foreign investors.

The major provisions of the Land Code address the right of individuals to own, buy and sell land. It classifies land into seven categories, based on potential use including agricultural, industrial and natural reserve lands. The mix of state control and ownership rights varies with each type of land. It is easier to own, buy, sell, and mortgage industrial land than agricultural land. The Code forbids the sale of agricultural land until 2008, and restricts agricultural land purchases by any one legal entity (Ukrainian citizen or Ukrainian-based business) to no more than 100 hectares until 2015. Efforts to cancel the moratorium on agricultural land sale in 2007 failed. The Rada voted to override President Yushchenko's veto of the moratorium, citing the need to first strengthen the legal framework covering land sale, while Yushchenko called on the Rada to hasten passage of legislation necessary to end the moratorium. The Land Code continues to prohibit foreigners from owning agricultural land directly. The creation of a legal Ukrainian-registered business to purchase and manage land in Ukraine is not prohibited. The Land Code codifies the state's right to oversee private land transactions via registration, the court system and dispute mediation and broad government/state rights to "influence" the land market. On June 5, 2003 the Rada adopted a new law on mortgages. The law allows the use of agricultural land as collateral and spells out foreclosure and eviction procedures. The U.S. Government via USAID sponsored a land titling initiative that provided technical assistance both to reduce the cost of agricultural land titling and to provide direct support for the issuance of land titles.

Ukraine's law "On Ownership" recognizes private ownership and includes Ukrainian residents, foreign individuals, and foreign legal entities among those entities able to own

property in Ukraine. It permits owners of property (including foreign investors and joint ventures) to use property for commercial purposes, to lease property, and to keep the revenues, profits, and production derived from its use. The law "On Ownership" is not comprehensive and mechanisms for the transfer of ownership rights are weak. Some difficulties have arisen when foreigners acquire majority control of enterprises, with the government or the current management in some cases continuing to exercise effective control of company decisions.

A.7. Protection of Property Rights

MORTGAGE

During the last few years, Ukraine's policymakers have launched many initiatives to develop a mortgage market, which has resulted in a strong increase in the number of mortgages and laid the legislative and administrative groundwork for a functioning mortgage market. In late 2002 Ukraine adopted a law on "Withholding Land Shares in Kind." In June 2003, a law "On Mortgages" was adopted. The GOU created the State Mortgage Institution (SMI) in October 2004 with authorized capital of UAH 50 million (\$10 million) as a liquidity facility largely aimed at putting downward pressure on lending rates by allocating capital efficiently. The 2006 budget allocated UAH 1 billion to issue state guarantees on loans to SMI that was approved in late December. The SMI will begin issuing corporate securities during the first quarter of 2007. The use of mortgages in Ukraine to secure ownership in property is growing - apartments, houses, office buildings, other types of buildings, and summer house (dacha) plots have secured mortgages. Development of the secondary mortgage market is underway -- enabled by passage of the Covered Bond Law in late 2005. USAID currently has a pilot covered mortgage bond in registration at the SSMSC to demonstrate how mortgages can be traded as securities. USAID helped create of a pledge registry, the first of its kind in the former Soviet Union, which applies to individuals' obligations with regard to movable property and tax liens. Though rudimentary, the registry is nationwide, providing a more transparent lending market for personal property.

INTELLECTUAL PROPERTY RIGHTS

Ukraine was the only country named a Priority Foreign Country in the 2002-2005 Special 301 reviews conducted by USTR, based on widespread piracy of copyrighted goods such as compact discs (CDs) and digital video discs (DVDs). The United States withdrew Ukraine's benefits under the Generalized System of Preferences (GSP) program in August 2001 and imposed \$75 million worth of sanctions on Ukrainian imports on January 23, 2002. These latter sanctions, which affected a number of Ukrainian products, including metal, footwear, and chemicals, were lifted on August 30, 2005 after the Ukrainian Government secured passage of important amendments to the Optical Disc Licensing Law, which went into effect on August 2, 2005.

In January 2006, USTR conducted a Special 301 Out-of-Cycle Review (OCR) of Ukraine to assess Ukraine's implementation of the new amendments and its overall trend of enforcement since the time that sanctions were imposed. In recognition of the GOU's efforts to improve the enforcement and protection of intellectual property rights, the United States lowered Ukraine's designation under Special 301 from Priority Foreign Country to Priority Watch List and reinstated GSP benefits. Enforcement has been improving and the new amendments enhanced law enforcement's role and lowered the threshold for imposing penalties and sanctions. Ukraine agreed to work with the U.S. Government and with the copyright industry to monitor the progress of future enforcement efforts through the Enforcement Cooperation Group. Despite these efforts, Ukraine remains a trans-shipment point, storage location, and market for illegal optical media produced in Russia and elsewhere. In November 2006, the Rada passed an amendment to the Customs

Code granting customs officials greater authority to protect intellectual property rights.

Ukraine is an active member of the World Intellectual Property Organization and a signatory to a number of international agreements and conventions. As part of its ongoing efforts to negotiate accession to the WTO, Ukraine has adopted legislation, including a May 2003 Omnibus package, to bring its laws into compliance with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). In November 2006, the Rada passed amendments to the Law of Ukraine "On the Protection of Rights to Indications of Origin of Goods" that ensured national treatment and most-favored-nation (MFN) for geographical indications.

Ukraine is in the process of strengthening its legal protections for pharmaceutical test data that pharmaceutical companies must submit to government authorities to obtain marketing approval. Patent and trademark violations are common in Ukraine, and U.S. industries have reported widespread counterfeiting of pharmaceuticals and consumer products. The Ukrainian Ministry of Health reportedly does not check the validity of patents when it permits pharmaceutical sales in Ukraine. In one case, the Ministry of Health allowed a European company to register the same drug for which a U.S. company held a valid patent. Ukraine improved its protection of pharmaceutical data through November 2006 amendments to the Law "On Medicinal Drugs," introducing a five-year period for protecting undisclosed information in the course of medicinal drugs registration.

The State Department of Intellectual Property (SDIP) is responsible for the formulation and implementation of Ukraine's intellectual property policy. In order to improve IPR enforcement, the Ministry of Internal Affairs and the State Customs Service have also set up units to deal exclusively with IPR violations. These under-staffed units have difficulty dealing with the large number of IPR infringements. Amendments to the Criminal Code of Ukraine passed in February 2006 lowered thresholds, so that violations with smaller amounts of damage to rights holders can also be prosecuted as IPR infringement. However, in many cases, the rights holder must actively engage with the Ministry of Internal Affairs or the State Customs Service to obtain enforcement. Implementation and enforcement of these new amendments and other existing intellectual property laws have been ongoing with some positive results. During the first 10 months of 2006 law enforcement authorities opened 381 IPR-related criminal cases, compared with only 104 in 2005. Only 40 offenders actually received sentences during the first six months of the year. Judges too often dismiss cases for improper reasons, or hand down minimal sentences. Generally speaking, the number of judges trained in IPR law remains low.

Trademarked and copyrighted goods must be registered for a fee (\$400 for the first good for the first year) in Customs' rights holder database in order to be guaranteed protection. Optical discs, however, also receive protection under the import-licensing regime, so few recording or motion pictures companies bother to register. Generally low confidence in the Ukrainian judicial system has meant few enterprises have brought private lawsuits to protect intellectual property rights. Legal experts and government officials have called for the formation of a special patent court in Ukraine to adjudicate patent cases, but to date there has been no concrete action towards this end

A.8. Transparency of the Regulatory System

TRANSPARENCY OF REGULATORY POLICIES

While there has been progress on deregulation, the number of regulations, required certificates, and inspection regimes in Ukraine still impose a significant regulatory

burden on private enterprise. In response to presidential decrees No. 799 dated May 12, 2005 "On Liberalization of Business Activity and State Support of Entrepreneurship" and No. 901 dated June 1, 2005 "On Some Measures to Ensure Enforcement of State Regulatory Policy," the State Committee for Regulatory Policy and Entrepreneurship (SCRPE) undertook a review of regulatory acts. By the end of 2005 the Committee had reviewed 9340 regulatory acts, 52.8% of which it decided to cancel. Review of Ukraine's regulatory policies was dormant in 2006.

BUREAUCRATIC PROCEDURES

While the time and costs related to business registration have been reduced, the GOU still requires enterprises to obtain numerous permits to conduct business. On January 5, 2006 the law "On Permits System in Economic Activity" entered into force. As a result of this law, more than half of required permits have been cancelled and the number of locations for obtaining permits has increased six fold. The Yushchenko government also streamlined business registration procedures, expanding "One-stop Registration Shops" and introducing a new "Single Window" for customs registration procedures. On September 30, 2006 a new law on registration procedures, which further simplified the procedure to start a business and reduced registration costs, entered into force. In some places one can now register a business within two to three days, instead of two to three weeks, as in the past. The World Bank "Doing Business" database rated Ukraine 101st in 2006 for ease in starting a business, up from 122nd in 2005. The World Bank estimated that it took 33 days and \$140.18 (9.2% of GNI per capita) to open a business in Ukraine in 2006; OECD averages are 16.6 days and 5.3% of GNI per capita.

LICENSING

Ukraine applies both activity and import licensing regimes. A Law "On Licensing Certain Types of Economic Activities" of June 2000 (and amended on January 17, 2002) provides a list of activities subject to licensing. Licensing applies to nearly 60 goods and services and is meant for protection of human, animal or plant health, the environment, public morals, and national security, or for prudential regulation of the financial sector. Businesspeople continue to cite burdensome activity licensing requirements as major impediments to commerce in Ukraine. Fees are described as high and compliance burdensome, particularly for telecommunications equipment. Import licenses are required for some goods, primarily pesticides, alcohol products, optical media production inputs, some industrial chemical products and equipment containing them, official foreign postage stamps, excise marks, officially stamped/headed paper, and checks and securities.

RULEMAKING/INSPECTIONS

Proposed draft laws and regulations are available on the Rada website for public review, but there is no formal procedure for submitting comments.

Current Ukrainian legislation envisages a mandatory financial inspection of a business entity per year and requires a minimum of 10 days notice. Non-financial inspections (i.e. taxes, fire safety, sanitation, etc.) can be burdensome and impediments to doing business in Ukraine.

CERTIFICATION/HEALTH AND SAFETY POLICIES

Technical standards and certification requirements are imposed on many imports. The certification body is the State Committee of Ukraine for Technical Regulation and Consumer Policy ("DerzhSpozhyvStandard"). Although Ukraine belongs to several international standardization bodies, such as the International Organization for Standardization (ISO), for many years it generally had not recognized foreign product certificates, even if they are issued in line with international standards, unless recognition is

mandated through an international treaty signed by Ukraine. Standardization procedures can be lengthy, burdensome, and expensive; standards can be vague, inflexible, and subject to frequent changes.

Numerous certification bodies continue to operate independently without coordination or oversight. Local, regional, and municipal authorities often require additional documentation beyond that required by certification bodies. As of November 2006, DerzhSpozhyvStandard had a network of 115 accredited product certifying bodies, including 53 accredited certifying bodies for quality management systems, as well as about 780 testing laboratories throughout Ukraine. Moreover, appropriate resources, such as modern analytical equipment and reactants, are not available in most laboratories. Quality management systems are also needed to ensure testing is done within an acceptable margin of error. DerzhSpozhyvStandard's system includes 28 state centers for standardization, systematizing weights and measures, certification and 27 territorial departments for consumer protection. Companies seeking testing should first contact DerzhSpozhyvStandard.

Importers can apply for three types of technical standard certificates: a certificate for a single batch of goods; a certificate for one year, which is valid for all imported goods during that year with one or two additional selective tests (this type of certification is the most common in Ukraine, covering 70% of issued certificates); and a certificate for 5 years, for which mandates inspection of production facilities.

In addition, Ukraine applies a range of sanitary and phytosanitary (SPS) measures, many of which do not appear to be consistent with an international, science-based approach to regulation. The certification and approval process is lengthy, duplicative, and expensive, with politics and corruption still often behind arbitrary application of regulations. Amendments to the laws "On Quality and Safety of Food Products and Food Raw Materials," "On Veterinary Medicine," "On Plant Quarantine," and others, to bring Ukrainian legislation in compliance with requirements of the WTO Agreement On Sanitary and Phytosanitary Measures, passed in 2005 and 2006.

For many years, Ukraine has worked to bring its standardization system into conformity with the European Standards System. The law "On Assurance of Conformity" is replacing mandatory certification for many types of products with assessment procedures in conformance with international standards and the "New Approach" directives of the European Union, including the principle of "presumption of conformity to standards." On August 1, 2002, the National Accreditation Body started operations to ensure the use of standards and procedures consistent with European Cooperation for Accreditation (ECA) policy.

TAYLOR